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In The Supreme Court of the United States

October Term, 1951

No. 642

P. J. LYNCH,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent,

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE NINTH CIRCUIT
AND
BRIEF IN SUPPORT THEREOF

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Supreme Court of the United States

October Term, 1951

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P. J. LYNCH,

Petitioner and
Appellant below,

vs.

UNITED STATES OF AMERICA,

Respondent and
Appellee below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

To The Honorable Supreme Court of the United States:
Your petitioner respectfully shows:

Summary Statement of the Matter Involved

This case is one of the seven companion cases brought by seven individual transferees of the Washington Fruit & Produce Company, a corporation, for the recovery of

excess profits taxes and declared value excess profits taxes assessed against and collected from these individuals as transferees of the corporation. It was stipulated by counsel that in all prior proceedings a determination of the instant case would be decisive in the other six actions (R 26-28; 144), and such stipulation has been extended to cover this petition and any subsequent proceedings.

On February 28, 1944, the Washington Fruit & Produce Company was a Washington corporation engaged in growing, storing, preparing and marketing fresh fruits at Yakima, Washington (R 37, 43, 53). On that date, the trustees of the corporation declared a dividend to the stockholders of 21,977 boxes of field-run apples owned by the corporation and stored within its warehouse (R 28-31). Petitioner was the owner of 25 per cent of the capital stock of the corporation, and as such was entitled to 5494 boxes. On the same day, the stockholders agreed to pool their apples and entered into an agreement with the corporation to wash, sort, pack, store and market the apples, and thereafter account to them for the net proceeds (R 32-35). The corporation fulfilled this agreement and disbursed the proceeds to the stockholders (R 33, 37). The agreement with the corporation was similar to other agreements which the corporation had with third persons (R 43, 74).

Petitioner reported the fair value of the apples received as a dividend in kind, as dividend income, and also

reported as income the profit received on the sale of the apples.

On April 29, 1944, the corporation was dissolved and the former stockholders continued the business, without interruption, as partners. Subsequently, petitioner, as one of the corporate transferees, was assessed his proportionate share of excess profits tax and declared value excess profits tax claimed to be due respondent from the corporation for the tax period ending on the date of dissolution (R 4-8). The tax claimed to be due from the corporation (and its transferees) was by virtue of the inclusion, as corporate income, of the excess value received by the stockholders in the later sale of the apples over the basis of those apples to the corporation (R 4-8). The increase resulted from a ruling by the Commissioner of Internal Revenue that the dividend in kind was not a true dividend, and that the income from the sale of the apples was in reality the income of the corporation, not the stockholders (R 4-8).

In addition, the corporate income was increased for the same year by another ruling. During 1944, and for prior years, the corporation also engaged in storing certain commodities under contract with the Federal Surplus Commodities Corporation (R 37-38). The provisions of the contract required full compliance with all contractual conditions and submission of a correct claim as a contingency of payment. The contract required the safekeeping and delivery of the commodities stored. Normal procedure

and custom for all storage was to await shipment from the warehouse before making any charge therefor (R 40-41). Corporate accounting of storage accounts was under a completed contract method.

Upon dissolution on April 29, 1944, the corporation, through its transferees, was required to include as income the value of the storage accounts on that date (R 4-8). This determination was made upon the theory that the corporation had the right to payment as of that date and for that reason the accounts should be accrued.

The applicable statutes of the Internal Revenue Code are Sections 22 (a), defining "gross income," and 115 (a), defining "dividend" (26 U. S. C. Sections 22 (a), 115 (a)).

As a transferee of the corporation, petitioner paid his proportionate share of the excess profits tax and declared value excess profits tax assessed by reason of the rulings referred to above. Following rejection of his claim for refund (R 6-8), petitioner brought this action for the recovery of such assessments in the amount of $10,000.00. Trial was had before the United States District Court for the Eastern District of Washington, Southern Division, following which the court rendered judgment in favor of petitioner upon the dividend in kind issue in the amount of $2,152.75, and against petitioner upon the storage accrual issue (R 18-19).

Thereafter, respondent herein appealed to the United

States Circuit Court of Appeals for the Ninth Circuit from that portion of the judgment in favor of petitioner herein; and petitioner cross-appealed from that portion of the judgment denying petitioner recovery upon the storage accrual issue (R 19, 22).

On November 23, 1951, the Circuit Court of Appeals entered judgment reversing that portion of the judgment in favor of petitioner upon the dividend in kind issue, and affirming that portion of the judgment denying petitioner recovery on the storage accrual issue (R 162-163). Upon the dividend issue, the Circuit Court reversed the finding of fact made by the District Court, and ruled that the dividend in kind was not a true dividend (R 156-158). Upon the storage accrual issue, the Circuit Court upheld the District Court's ruling that the true method of reflecting corporate income required the accruing of storage accounts as of the date of corporate dissolution (R 159-162).

A petition for rehearing, timely filed by petitioner, was denied by the Circuit Court by order entered December 27, 1951 (R 163).

JURISDICTIONAL STATEMENT

It is contended that this Court has jurisdiction to review the judgment here in question under 28 United States Code, Section 1254 (1).

QUESTIONS PRESENTED

1. Did the dividend in kind of apples constitute a true dividend, taxable as income to the petitioner-stockholder, upon the subsequent sale of which, after improvement, the gain therefrom would be the income of petitioner-stockholder?

2. Where the assets of the dissolved corporation are transferred to all former stockholders who continue the business, without interruption, as partners, is the dissolution sufficient grounds for requiring a change of corporate accounting to include storage accounts as corporate income, as of the date of dissolution, when there is no right to payment for such storage as of that date?

3. Where the trial court, following trial without jury, makes and enters a finding of fact based upon substantial evidence, may a Circuit Court of Appeals reverse that finding as erroneous?

REASONS RELIED ON FOR ALLOWANCE OF WRIT

1. The decision of the Circuit Court of Appeals is inconsistent with decisions of other Circuit Courts upon the same matter and is in conflict with applicable decisions of this Court in holding that the normal tax consequences of a legitimate business transaction and the transaction itself are avoided because the motive thereof is the reduction of income taxes.

2. The decision is inconsistent with applicable decisions of other Circuit Courts and this Court in requiring, on corporate dissolution, the accrual, as income, of storage accounts, when all conditions precedent to the right to payment for such storage had not been performed as of the date of dissolution.

3. The decision is in conflict with applicable decisions of this Court, is a departure from the usual course of judicial proceedings, and requires the supervision of this Court because it avoids the rule that a finding of fact by the trial court is not clearly erroneous where it is based upon substantial evidence.

WHEREFORE, your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Circuit Court to the end that this cause may be reviewed and determined by this Court as provided for by the statutes of the United States; and that the judgment herein of said Circuit Court be reversed by this Court, and for such further relief as to this Court may seem proper.

Dated March 1, 1952.

P. J. LYNCH
by C. W. Halverson
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E. F. VELIKANJE
JOHN S. MOORE, JR.
of Counsel

Supreme Court of the United States

October Term, 1951

No.....

P. J. LYNCH,

Petitioner and Appellant below

vs.

UNITED STATES OF AMERICA,

Respondent and Appellee below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Opinions of Courts Below

Judgment of the trial court was entered in the United States District Court for the Eastern District of Washington, Southern Division, on October 30, 1950 (R 18-19). The opinion of the United States Circuit Court of Appeals for the Ninth Circuit (R 154-162) is reported in 192 F 2d 718.

JURISDICTION

1. The date of the judgment to be reviewed is November 23, 1951. A petition for rehearing was denied on December 27, 1951 (R 163).

2. The statutory provision which is believed to sustain the jurisdiction of this Court is 28 United States Code, Section 1254 (1).

3. The determination of the Circuit Court should be reviewed by this Court because it is in conflict with the decisions of other Circuit Courts of Appeal upon the same matter and with applicable decisions of this Court as to the points hereinafter set forth by Argument. In addition that determination so far departed from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision as hereinafter set forth by argument.

STATEMENT OF THE CASE

A statement of the case has already been made in the preceding petition for writ of certiorari und[illegible] 1 (pp. 3-7), which is hereby adopted and made a part of this brief.

SPECIFICATION OF ERRORS

1. The Circuit Court of Appeals for the Ninth Circuit erred in holding that the dividend in kind declared by the trustees of the Washington Fruit & Produce Company, a corporation, was not a true dividend.

2. The Circuit Court of Appeals for the Ninth Circuit erred in holding that storage accounts for which the corporation was not then entitled to payment should be included as corporate income as of the date of corporate dissolution.

3. The Circuit Court of Appeals for the Ninth Circuit erred in reversing the finding of fact by the District Court "that the dividend in kind was a true dividend," which finding was not clearly erroneous and was supported by substantial evidence.

ARGUMENT

Summary of Argument

Point A. The Circuit Court of Appeals for the Ninth Circuit denied the validity of the dividend in kind as a true dividend for the reason that the motive for the declaration thereof was the reduction of income taxes. This ruling is in conflict with applicable decisions of this Court and other Circuit Courts of Appeal.

Point B. The Circuit Court of Appeals for the Ninth Circuit required a change of accounting method upon corporate dissolution in order to establish as corporate income storage accounts for which the corporation was not then entitled to receive payment. This ruling is in conflict with applicable decisions of this Court and other Circuit Courts.

Point C. The Circuit Court of Appeals for the Ninth Circuit reversed a finding of fact made and entered by the trial court, which finding was supported by substantial evidence. This ruling is in conflict with applicable decisions of this Court and is such a departure from the accepted course of judicial proceedings as to call for the exercise of this Court's power of supervision.

Point A

The declaration of the dividend in kind was deemed by the Circuit Court not a true dividend because the motive of tax reduction avoided its substance and validity.

A dividend is a distribution to shareholders of corporate earnings and profits *(Commissioner of Internal Revenue v. Bedford's Estate,* 65 S Ct 1157, 325 U S 283, 89 L ed 1611), while a dividend in kind is a distribution to shareholders in any medium other than money *(Commissioner of Internal Revenue v. First State Bank of Stratford,* 168 F 2d 1004, 5th Cir.).

The motive of a taxpayer to reduce or escape the payment of a tax does not affect the validity of the transaction by which the taxpayer seeks to achieve that result *(Gregory v. Helvering,* 293 U S 465, 79 L ed 596, 55 S Ct 266).

If the method employed by the taxpayer to reduce or escape the payment of a tax is in reality that which it appears to be, the fact that taxes are reduced or avoided, and that such was contemplated, is immaterial *(Gregory v. Helvering,* supra; *U. S. v. Cumberland P. S. Company,* 338 U S 451, 94 L Ed 251; 70 S Ct 280; *Chisholm v. Commissioner of Internal Revenue,* 2d Cir., 79 F 2d 14; *United States v. Cummins Distilleries Corporation,* 6th Cir., 166 F 2d 17).

The Circuit Court in making the determination denying the validity of the dividend because motivated by a desire to reduce taxation, quoted and cited *Commissioner v.*

Transport Trading & Terminal Corp., 176 F 2d 570, 572, 2d Cir. (R. 157). That decision and the decision of the Circuit Court in the instant case have established a real conflict with the decisions of other Circuit Courts and this Court as above set forth.

Point B

The corporation maintained an accounting method similar to completed contract upon storage accounts, making a charge therefor and receiving payment upon shipment and delivery of the stored commodities. Although by custom and contract, the corporation had no right to payment as of the dissolution date, storage accounts existing as of that date were required to be taken as corporate income.

A method of accounting shall fairly and honestly reflect the income of the taxpayer. *Kentucky Color & Chemical Co. v. Glenn*, 87 F Supp. 618, D. C. Ky.; *Osterloh v. Lucas*, 37 F 2d 277, 9th Cir.; *Huntington Securities Corporation v. Busey*, 6th Cir., 112 F 2d 368.

A completed contract method of accounting is a type of accrual basis, contingent upon certain conditions.

Actual receipt determines income under the cash basis; a fixed or unconditional right to receive payment determines accrual income. *Franklin County Distilling Company v. Commissioner of Internal Revenue*, 6th Cir., 125 F 2d 800; *H. Liebes & Co. v. Commissioner of Internal Revenue*, 9th Cir., 90 F 2d 932.

Accrual as income is required only when the events occur to fix the amount due and determine the liability to pay. *Commissioner of Internal Revenue v. Edwards Drilling Co.*, 5th Cir., 95 F 2d 719.

The decision of the Circuit Court is in conflict with the decisions of other Circuit Courts in determining as corporate income that for which there was no realized gain nor fixed right to receive payment on the date of dissolution.

Point C

The determination of the dividend in kind issue was based solely on the question of whether or not the dividend in kind was a true dividend. The trial court made a finding that it was a true dividend, based upon substantial evidence. The Circuit Court reversed that finding as erroneous.

Rule 52(A) of the Federal Rules of Civil Procedure requires that findings of fact shall not be set aside unless clearly erroneous.

Findings by the trial court are binding on appeal if the records offer an adequate basis for the conclusions and inferences drawn by the trial court *(U. S. v. Cold Metal Process Company*, 164 F 2d 754, 6th Cir.).

The appellate court's determination should be limited to whether the inferences and conclusions of the trial judge in making findings of fact have any substantial basis in the evidence, and if such basis is present, the findings of the trial court must be accepted. *Gaytime Frock Company v.*

Liberty Mutual Insurance Company, 148 F 2d 694, 7th Cir.

Even though different reasonable inferences may fairly be drawn from the evidence, the appellate court should not disturb the findings of the District Court unless they are clearly erroneous. *Tennessee Coal, Iron & R. Company v. Muscoda Local No. 123*, 137 F 2d 176, 5th Cir.; *Bostian v. Levich*, 134 F 2d 284, 8th Cir.

The findings of the District Court which are supported by evidence or which are based upon reasonable inferences drawn from evidence, are not clearly erroneous. *Cray, McFawn & Co. v. Hegarty, Conroy & Co.*, 109 F 2d 443, 2d Cir.; *Reynolds Metal Co. v. Skinner*, 166 F 2d 66, 6th Cir. See also, *Commissioner of Internal Revenue v. Court Holding Company*, 324 U S 331, 89 L ed 981, 65 S Ct 707; *Dobson v. Commissioner of Internal Revenue*, 320 U S 489, 88 L ed 248, 64 S Ct 239; *Commissioner of Internal Revenue v. Scottish American Invest. Co.*, 323 U S 119, 89 L ed 113, 65 S Ct 169.

The action of the Circuit Court in reversing the findings of fact is in direct conflict with applicable decisions above set forth, and calls for the exercise of this Court's power of supervision.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, by granting a writ of certiorari and thereafter re-

viewing and reversing said decision of the Circuit Court of Appeals for the Ninth Circuit.

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